Portability of Superannuation Balances*

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Introduction

Over the last two decades the Australian financial system has experienced substantial deregulation, but the superannuation sector has run counter to this overall trend. While the superannuation sector has become a major segment of the financial system, it is our conjecture that this growth has been the result of compulsion not choice by economic agents. There are two forms of compulsory contributions to superannuation: the first is award superannuation under which employers are required to contribute three per cent of wages to a superannuation fund specified in the award. The second is the Superannuation Guarantee, SG, under which employers are required to pay a specified proportion of salary, currently nine per cent, to a superannuation fund of their choice. Although these contributions are fully vested and trustees are required to invest such contributions for the benefit of members, employees have no effective choice about which fund is to receive their contributions and no choice about whether to retain accumulated balances in the original fund.

In this paper, we argue that this lack of choice violates the fundamental principle of consumer sovereignty under which it is held that consumers are the best judges of their own welfare and ought to be able to consume anything they can afford to buy. Similarly, in the investment area, consumers are the best judges of their own welfare and should be able to place their retirement savings in any product they choose.

The lack of choice of both initial and subsequent superannuation fund leads to a lack of competition in the superannuation sector. Trustees of superannuation funds are assured of both a flow of captive contributions and stability of accumulated balances which removes incentives to operate the fund at lowest cost much less in line with member preferences. Most superannuation fund accounts are held in defined contribution (or accumulation) funds so the members of those funds bear the full investment risk but have little say over the investment policy of the fund.

The Commonwealth government had announced its policy allowing members of superannuation funds to have unrestricted choice on portability of accumulated balances in superannuation funds and had published the regulations under the Superannuation Industry Supervision Act (SIS Act). The proposed date under which these would have

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become effective was July 2004; however, these regulations have been disallowed by the Senate in September 2003.

In this paper, we distinguish between choice of superannuation fund (which would allow employees to select the fund in which their contributions are placed) and portability of superannuation balances, under which employees would be able to transfer their accumulated balances to another superannuation fund. The Commonwealth Government’s policy on choice of superannuation fund was defeated in the Senate in 2001. There is a close link between the two policies but it is feasible there could be one without the other. Later in the paper we discuss this link.

The paper initially examines the issues under portability and proceeds under the following sections: an economic analysis of portability of accumulated balances; Wallis Committee recommendations; current Government proposals; and, possible answers to objections to portability.

ECONOMIC ANALYSIS OF PORTABILITY OF ACCUMULATED BALANCES

Superannuation funds operate as trusts; the trustee is the legal owner of the assets in the superannuation fund and invests them for the beneficial owners, the members. Trustees have explicit duties under common law and legislation including the SIS Act to act prudently and in the interests of beneficiaries. However, Drew and Stanford (2003c) argue that, generally, members, who are not allowed to appoint or direct trustees, have no influence over trustee decisions and that trustees are unduly influenced by funds managers to operate funds for the benefit of funds managers. This has important implications for the operational efficiency of the superannuation sector. Under current circumstances, trustees have no obligation to allow members to transfer accumulated balances between funds so that members have no way to influence trustees’ decisions. For members of superannuation funds, their accumulated superannuation balances are an illiquid, unmarketable long term asset because, while superannuation contributions are fully vested in members, superannuation balances must be preserved in the superannuation environment until at least age 55; current policy arrangements are to extend this progressively to age 60 by 2025.

Under current arrangements, members have no choice of fund (i.e. the right to select the fund to which their contributions will be directed) and no general right to transfer accumulated balances from one fund to another. Both of these restrictions represent a welfare loss to members, as members will incur higher costs and lower returns as a result of inappropriate investment strategies than alternative strategies which are available. We would predict that the introduction of portability of superannuation balances would increase welfare.

The current position is made worse by the absence of effective consumer protection measures. The Australian Prudential Regulation Authority (APRA) has a corporate culture of referring member complaints to the superannuation fund for reply, Stanford, (2003). Moreover, the Australian Securities and Investment Commission (ASIC), is reluctant to act on consumer complaints about superannuation fund performance, Valentine (2003). Trustees are supposed to act in the interest of members but, in general do not as trustees are 'managed' by asset consultants and funds managers, Drew and Stanford (2003a). Trustees who are generally inexperienced in financial matters accept the conventions of the funds management industry as espoused by asset consultants and funds managers. These conventions include a reliance on active funds management (despite the evidence that active managers underperform benchmarks), a fee structure which is a flat percentage of funds under management (FUM) rather than a flat management fee with an incentive bonus for outperformance. Trustees support the goal of funds managers to maximise FUM. The interests of fund managers are threatened by proposals for extended portability of superannuation balances so that it comes as no surprise to see that the broader funds management industry opposes portability on the paternalistic ground that members are unable to select the appropriate fund.

The effect of portability would be to re-allocate balances between funds, but it is important to note that there is no possibility of a "run" on superannuation funds as balances are preserved till at least age 55 (as noted above current policy is to extend this to age 60 years.). If members took the opportunity to consolidate balances into a smaller number of accounts, there is no *a priori* expectation that any particular class of funds or particular funds would suffer a net outflow of funds. Moreover, the net transfer of funds would be reduced considerably if there was a clearinghouse arrangement (analogous to bank clearinghouses) so that considerable "netting" takes place prior to settlement.

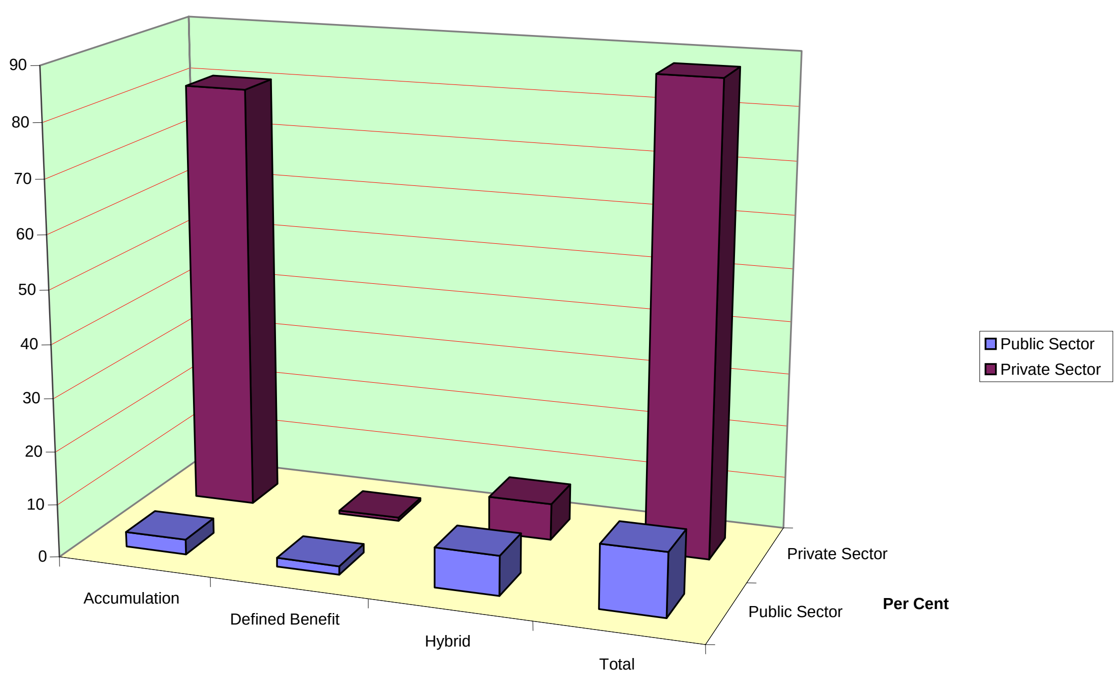
However, the possibility of a major transfer of balances between funds would occur if members chose to transfer funds from one class of funds to another class of funds. In this event, we would argue a major transfer of funds from a particular fund is evidence of member dissatisfaction with the trustees and their policies and, thus, is further evidence that trustees are not fulfilling their duties to members. One would hope that, in these circumstances, trustees would review their procedures and policies so as to reduce the outflow of funds and the quasi-rents garnered by funds managers. If trustees do not respond, the appropriate response is *not to place limits on portability but to replace the trustees*.

It might be expected that trustees will attempt to erect barriers to portability through the imposition of exit fees. In general, there is little justification for such fees. Trustees have little difficulty in unwinding investments as most fund assets are placed on highly liquid exchange traded markets so that there is no difficult in realising assets at short notice. Trustees are unlikely to experience short term cash flow problems as now SG contributions are required to be paid quarterly and there are regular flows from interest and dividends, and maturing discount securities. Funds which would experience cash flow problems in these circumstances are poorly managed and require a change in management policies or closure.

In the superannuation system, there are two types of funds: defined benefit funds (DBF) and accumulation or defined contribution funds (DCF). DBF funds promise a retirement benefit defined in an objective way, usually final salary and years of service so that typical retirement benefits are a pension of *x* per cent of final salary subject to a qualifying period or a lump sum equivalent to y times final salary. Under DFB funds the liability to meet the promise is assumed by the fund's sponsor, usually the employer. On the other hand, in a DCF, the retirement benefit is simply the accumulation of contributions and earnings less expenses. Under a DCF, members bear the entire investment risk whereas in a DFB fund this risk is carried by the employer. For this reason, *we argue that portability needs to apply only to members of defined contribution or accumulation funds* as the expected value of the terminal benefit to members of these funds is uncertain (as it depends on the investment performance of the strategy implemented by trustees). Most superannuation accounts are held in defined contribution or accumulation funds; in these funds, the members bear entirely the investment risk i.e. the risk that trustee decisions will produce poor returns or high costs and thus it is appropriate that members should be able to choose the fund in which to hold their balances.

Figure 1 shows the membership of superannuation funds by sector of the economy; the major features to note are that the overwhelming majority of accounts are in private sector accumulation funds. Membership of defined benefit funds is a very small proportion of the total and largely confined to the public sector; membership of defined benefit funds has been declining for some time as such funds are closed to new members.

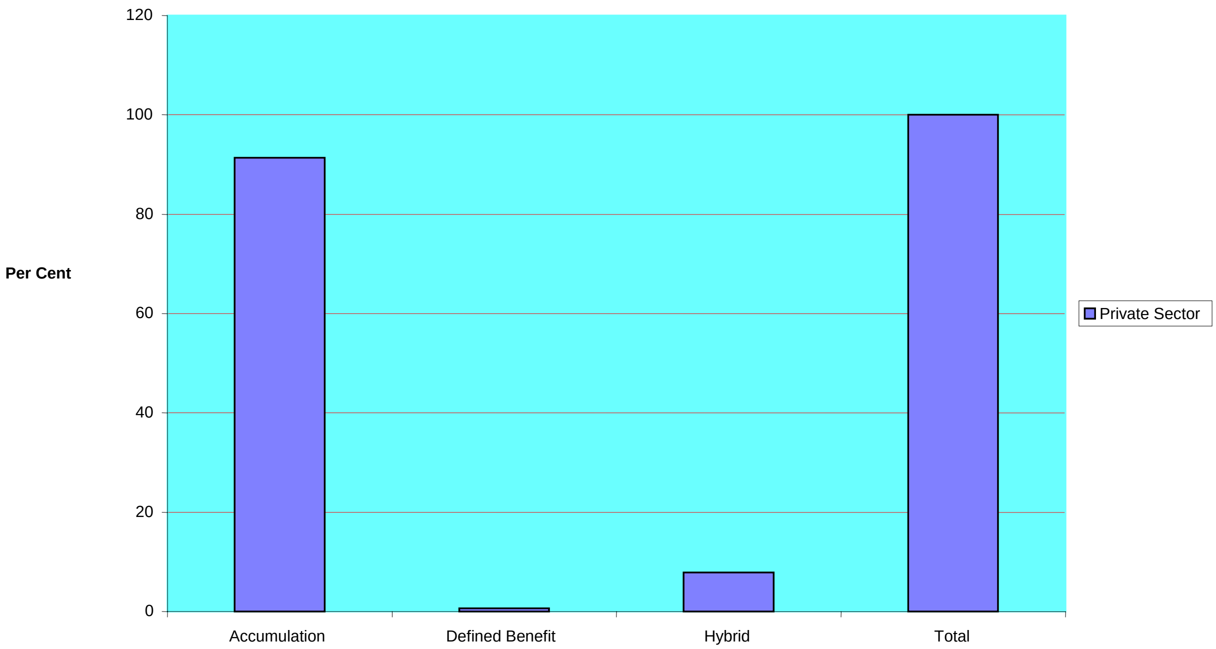
Figure 1: Membership of Superannuation Funds by Type of Fund and Sector, Australia, December 2002



Source: Calculated from APRA data.

Figure 2 confirms these observations, highlighting that over 90 per cent of superannuation accounts are held in accumulation funds.

Figure 2: Membership of Superannuation Funds, Private Sector, December 2002



Source: Calculated from APRA data

For members of DCF plans, the concept of accumulated balances is quite clear and the amount of accumulated balances in any particular circumstance can be readily and accurately calculated. This is not so for members of DBF funds whose entitlement is for a benefit payable at retirement conditional upon events which exist at retirement. As most DBF plans are unfunded (i.e. the fund holds no assets to back the liabilities which are paid from current revenue as they emerge). Most public sector DBF, particularly in the Commonwealth sector is characterized by this design. There would be very few members of funded DBF and, we would assert, none who were required to join such funds under the schemes of compulsory superannuation.

Although superannuation coverage of employees is now high with over 90 per cent of full-time employees covered under the SG with some of these also covered by award superannuation, there is a large proportion of the population with low accumulated balances in superannuation as a result of prolonged unemployment and withdrawal of women from the workforce to assume family responsibilities.

We take it that the goals of a member of an accumulation fund are to obtain the maximum terminal balance after making allowance for risk, i.e. to have the maximum balance at the age when the member can exit the superannuation system. We have formally demonstrated (see Drew and Stanford 2002a) that the important variables which determine the terminal balance are the gross investment returns earned by the fund and the expense rate of operating the fund; the net return is usually referred to as the crediting rate. The gross investment returns earned by the fund will depend on the asset allocation of the fund i.e. the proportion of the fund's portfolio in each asset class and the market return to each asset. The formal model we have used is readily converted to an Excel spreadsheet which enables calculation of terminal benefits under specified assumptions.

The expenses incurred by the fund are of two major types: administrative expenses which are usually charged as a flat dollar amount per annum and the expenses of investing the portfolio. For instance, the expenses of the university superannuation scheme, Unisuper, are an administrative fee of $127 a year and an average investment expense ratio of 0.37 per cent of FUM; as will be seen from the upcoming table this average investment expense ratio is low for the industry.

We argue that there is a clear strategy for members of superannuation to maximize their terminal benefit. This strategy is to concentrate on minimizing expenses. The general rules are to consolidate balances:

(1) To avoid paying the administrative expenses fee more than once;
(2) Into a fund which charges wholesale fees rather than retail fees (up to 80bps benefit); and;
(3) Into a passively managed fund rather than actively managed funds (up to 100bps benefit).

This rule says to combine similar accounts to reduce administrative fees. To give some idea of the gains from following rule (1) above are significant; saving an administrative fee of $127 a year would increase balances by nearly $8,500 over 30 years assuming an average earning rate of 5 per cent a year.

The second rule, to consolidate balances into an account charging wholesale fees rather than retail fees, will reduce both administrative costs and investment expenses. As shown in Table 1, all types of corporate superannuation funds have lower costs than retail funds so that it may be possible for a member to effect a saving of as much as 0.8 per cent or 80 basis points a year by following this rule. The effect of such a saving on accumulated balances after 30 years is material and, on reasonable assumptions, would increase the terminal benefits by at least 15 per cent.

The third rule, to consolidate balances into passively managed funds rather than actively managed funds, would also produce a material benefit for members. Malkiel and Radisich (2000) estimate that, in the USA, the investment expense ratio for a passively managed equity fund is 20 basis points a year; Pozen (2002) reports that, in the USA, the Federal Thrift plan, a retirement vehicle for most Federal employees, offers a small number of broadly diversified stock and index plans, (investment choice in Australian terminology), with an annual expense ratio of seven basis points (or .07 per cent). Allowing for the fact that some expenses may be absorbed by the employer, Pozen estimates that the full costs of pension plans based on the Federal Thrift plan would be 30 basis points per annum. We discuss the relative performance of actively and passively managed funds later but, for the moment, note that the majority of Australian superannuation funds are actively managed. The gains from following rule are potentially high (at the extreme 94 basis points a year for members of retail personal superannuation funds) but are material for all members except government funds. Importantly, implementation of all of these rules requires no detailed knowledge of funds or of the past returns of funds; nor does it require quantitative knowledge of the performance of funds.

We now ask if members can select funds which provide excess returns i.e. returns higher than a market benchmark. We have shown that retail equity superannuation underperform, after taking into account the risk exposure of the funds against standard benchmarks, Drew and Stanford (2003b) and we conclude from this that members of such funds are better served by a passively managed fund. This research confirms findings from the United States and the UK. We also have found that higher investment expenses are associated with lower returns to the portfolio, Drew and Stanford (2003c). Furthermore, any superior performance by active funds managers does not persist, Drew, Stanford and Taranenko (2001), Drew and Stanford and Veeraraghavan (2002); this supports the current convention that past performance data of superannuation funds does not provide an indication of future performance. However, we find that there is some evidence that the lowest cost cohort of wholesale funds have produced slight excess returns, Drew, Stanford and Veeraraghavan (2002). From this we conclude that there is no information which would enable members of superannuation funds to predict future performance and that it is pointless for members to attempt to do so. We conclude that the appropriate strategy for members with more than one superannuation account is to minimize costs by following our three rules above. Following these rules will also provide the best opportunity to increase the gross returns of the chosen fund.

Table 1: Costs of Superannuation Fund by Type of Superannuation Fund

Type of Fund	Investment Cost (% of FUM)	Administration Cost (% of FUM)	Distribution Cost (% of FUM)	Total Expense Rate (%)
Large Corporate Wholesale	0.34	0.38	0.33	1.05
Large Corporate Employer Master Trust	0.40	0.35	0.10	0.85
Large Industry	0.45	0.60	0.10	1.15
Government	0.20	0.23	0.00	0.43
Retail - Small Retail Employer Master Trust	0.60	0.90	0.50	2.00
Retail - Personal Super	1.24	0.60	0.50	2.34

Note: These costs exclude entry and exit fees.
Source: Rice and McEwan (2002)

The extent to which members can consolidate balances depends on the extent to which superannuation funds are open. Some funds accept as members only from a particular class of persons such as employees of a particular enterprise or industry. Some other funds are closed in the sense that they will not accept new members. An example of a fund which is closed in both senses is the Commonwealth Superannuation Schemes, one of the largest funds in Australia, is a fund exclusively for Commonwealth public servants; it has been, for some years, closed to new members.

What is important in accounting for costs of superannuation funds is access to wholesale investment rates (we discuss this later in the paper) and distribution costs. On both counts, retail funds have comparatively high costs. Costs of government funds are low because the administration of superannuation has been integrated into the payroll function and many government funds are un-funded.

WALLIS COMMITTEE RECOMMENDATIONS

The Wallis Committee recommended that superannuation fund members should have a greater choice of fund and that employees should be provided with choice of fund, subject to any constraints necessary to address concerns about administrative costs and fund liquidity.

The Wallis Committee specifically recommended that members should have the right to transfer the vested amounts to any complying fund. On exercise of that right, payments should be transferred to the chosen fund as soon as practicable, subject to controls necessary to maintain orderly management for the benefit of all fund members. Transfer costs, including those incurred as a result of regulatory requirements should be transparent and reasonable.

The Wallis Committee concluded that that fund management fees in Australia appear to be higher than those in comparable countries and that one of the major potential reasons for higher costs in Australia is the fragmentation of the managed funds industry and that rationalisation would be assisted by stronger competition and the removal of regulatory constraints on the amalgamation of funds. Stronger competition and other reforms may also drive further efficiencies. Regulatory changes which could improve the performance of superannuation sector include regulatory constraints in superannuation**.** The existing arrangements restrict competitive pressure in the sector which provides member choice of fund only to self-employed individuals; and members of public offer superannuation schemes, who, subject to exit fees, can transfer accrued voluntary entitlements to other schemes.

However, the Wallis Committee noted that member choice raises several concerns:

(1) Administrative costs for employers and funds are likely to be greater if freedom of choice is unfettered and can be exercised at will. If members exercise choice frequently, additional exit/entry fees may offset any increase in investment returns;
(2) Choice also raises issues for fund liquidity. Investment strategies may need to be adjusted to hold more liquid assets and may result in greater focus on short-term investment performance. However, the Committee pointed to United States' experience suggests that investor choice has not led to higher volatility in fund liquidity;
(3) These problems may be partly addressed by imposing some limitations on exit, such as a suitable notice period or limits on the frequency of change. Subject to these constraints, the additional competition engendered by choice is likely to put downward pressure on costs and to encourage rationalisation of the industry;

(4) Member choice will be successful in promoting competition only if consumers have appropriate information. It is the joint responsibility of the industry and regulators to ensure that consumers are educated and well informed. Education should cover issues such as the rights of members, different life cycle needs and their implications for risk and return, and the benefits and costs of exercising choice; and,
(5) Consumer protection will need to cover requirements for good disclosure, proper regulation of the sales and advice process (including licensing of investment advisers), and speedy dispute resolution where problems occur.

We maintain that the Wallis Committee has overestimated the difficulties associated with portability of balances. Earlier in the paper we argued that liquidity problems are likely to be minimal and advanced the normative proposition that trustees should not be protected from members' dissatisfaction manifested through withdrawal of balances. We also argue that once a portability regime has been established a high level of withdrawals is unlikely as the fundamental strategy to maximise retirement benefits is to adopt a passive buy and hold strategy under which market returns with only a small discount will be obtained.

CURRENT GOVERNMENT PROPOSALS

The current proposals of the Government are:

(a) To allow portability through changes in the regulations of the Superannuation Industry (Supervision) Act 1993 (SIS Act). There is, at present, no provision within the SIS Act that requires a fund to transfer benefits at the request of a member;
(b) Portability is to be implemented by way of regulations[1] which will require the trustees of all regulated superannuation funds to transfer an amount in respect of a member's superannuation benefits to another regulated superannuation fund[2], at the request of that member;
(c) The transfer will be subject to the receiving fund being willing to accept the transfer;
(d) Portability would apply to the withdrawal benefits[3] of a fund member; and,
(e) Funds would be required to transfer benefits as soon as practicable following receipt of a request from a member but within 90 days of the request.

These regulations provide a clear mechanism for the transfer of balances in a defined contribution fund but the Government wishes the portability proposals to be extended to members of a defined benefit scheme.

[1] Under sections 31 and 32 of the Superannuation Industry (Supervision) Act 1993 (SIS Act).
[2] The regulations apply also to ADF, RSA or EPSSS.
[3] The term 'withdrawal benefits' is defined in the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) (regulation 1.03).

We argue that extension of portability to defined benefits schemes is not necessary. The argument in favour of portability for members of defined contribution funds who, as has been stated previously bear the investment risk and hence has an unqualified right to determine where and how their contributions should be invested. Furthermore, the introduction of portability will correct a serious design fault of the original SG and award superannuation schemes. Nearly all people who joined superannuation schemes consequent on the introduction of compulsory superannuation became members of accumulation schemes.

Members of defined benefit schemes have an entitlement relating to defined retirement benefits; their current entitlements are the present worth of this entitlement at retirement. Many defined benefit superannuation schemes, particularly in the public sector, are unfunded and hold no assets against the current entitlements of members. The Government proposes to exempt such public sector schemes in the Commonwealth and States from the portability provisions. The remaining defined benefit schemes have relatively few members and portability provisions are a special case which should not be confused and lumped together with portability provisions accumulation schemes.

Exit Fees

The Government does not intend to impose new limits on exit fees considering that previous action in terms of a stronger disclosure regime for superannuation funds will mean that members are informed about exit fee prior to or shortly after joining a fund. Trustees are required to provide a Product Disclosure Statement (PDS) to members. The Government, however, reserves the right to regulate exit fees if there is evidence that exit fee arrangements were being structured for the purpose of preventing portability from operating as intended.

Freezing portability

APRA would be able to freeze the transfer of benefits or a proportion of benefits out of a fund to another fund where there are prudential concerns. Such concerns would arise if APRA has a reason to believe that the transfer of funds would prejudice:

(a) The financial position of the fund; or,
(b) The interests of the fund members.

In such instances, APRA would be able to suspend or vary the fund's obligation to pay the benefit for such period as APRA determines. APRA would also have the discretion to freeze portability of benefits where the trustee of the fund has made an application to APRA to do so. Once APRA had ceased a freeze, the maximum notification period for the transfer of benefits would recommence for any outstanding requests for transfer.

Consumer protection and disclosure issues

Many of the disclosure requirements that are necessary for portability are already provided by the Corporations Act 2001 (Corporations Act). The general disclosure requirements under the Corporations Act harmonise the disclosure requirements for financial products, including superannuation. In addition, the Corporations Act now provides enhanced service provider licensing and conduct regimes. Disclosure requirements for superannuation funds are provided under the Corporations Act, as amended by the Financial Services Reform Act 2001 (FSR amendments), which commenced on 11 March 2002. These disclosure requirements ensure that all prospective public offer fund members are made aware of the level of exit fees and other conditions prior to joining and transferring their benefits into a superannuation fund. At the time a superannuation interest is recommended or issued a Product Disclosure Statement (PDS) is required to be given to a prospective member. The PDS must include information about any amounts that will or may be payable, either by the holder or out of a common fund, in respect of the product after its acquisition, including exit fees.

Information about current fund

Members require information about their current fund and the status of their benefits. The Corporations Act disclosure obligations include a requirement for fund trustees to provide certain member and fund information after each reporting period (usually 12 months). This includes:

(a) The amount of the member's withdrawal benefit at the start of the reporting period;
(b) The amount of the member's withdrawal benefit at the end of the reporting period;
(c) The method by which that amount was worked out;
(d) The proportion of that benefit that must be preserved;
(e) The amount payable on a member's death and details of any disability benefits;
(f) A description of the fund's investment strategy and investment objectives of the fund;
(g) A statement of fund assets and information on the fund's rate of net earnings; and,
(h) Information relating to the fees, charges, expenses and administrative or other operational costs of the fund and the amount of fees and charges deducted by the fund from any account held in respect of the member.

The Government considers that fund trustees should also be required to provide information to members on request that would allow them to make an informed decision about the transfer of their superannuation benefits. This information should include the member's withdrawal benefit and amount of exit fees that would be payable at that point in time.

Market conduct
The FSR amendments to the Corporations Act have drawn together separate regulation of financial advice in relation to different types of financial products into a single licensing regime for persons seeking to carry on a financial services business. Accordingly, persons who advise on superannuation products (both life and non-life products) will be subject to licensing or authorisation requirements administered by the Australian Securities and Investments Commission. Licensed financial service providers are subject to a range of measures regulating their conduct and disclosure under the Corporations Act, designed to provide for a high level of consumer protection.

Education campaign
The Government would conduct an education campaign prior to the commencement of portability. The campaign would be designed to meet the information needs of both fund trustees and fund members.

POSSIBLE ANSWERS TO OBJECTIONS TO PORTABILITY

Some of the popular objections to portability include the following:

a) Members are unable to understand superannuation;
b) Members need more information about superannuation.

We argue that under compulsory superannuation, members are not required to understand superannuation as there are no actions required of members under the current arrangements where contributions are deducted before net earnings are paid to members; contributions are paid to a fund irrespective of the wishes of the member; contributions are invested by trustees without reference to members and the accumulated balances are paid to members on retirement from the workforce.

Under these arrangements it is not rational for members to take any steps to understand superannuation as gaining that understanding is a net cost. Nevertheless, it is clear that there is a high level of understanding of the problems of superannuation, as shown by surveys, as well as a level of dissatisfaction with the current superannuation arrangements[4].

We would point to contrary evidence that people can understand complex financial information and make rational choices in the face an extensive menu of choice. Since deregulation of the financial sector, the range of financial products available has increased dramatically. The Wallis Committee showed that prior to 1980, each mortgage loan provider offered an average of two varieties of mortgage products. These loans were also fairly basic, with limited flexibility in their terms and conditions

[4] Our information is that members are well aware of the problem of multiple accounts and that attempts to combine accounts are frustrated by an outright refusal of trustees to allow transfer of balances.

In 1996, there were approximately 1,760 differentiated mortgage products offered by a range of suppliers. The mortgage products included a range of residential, investment and equity mortgages offered by 150 financial institutions, each offering an average of 12 different mortgage products. There are more substantial differentiating features which include variable and fixed interest rate facilities, 'honeymoon' interest rates, redraw facilities and arrangements for setting off interest between savings and loan balances.

Consumers have been able to negotiate the new regime of expanded choice easily. The results of the deregulation of the financial sector and expanded choice have been to reduce interest rates paid by consumers and to reduce the margins of traditional lenders while, at the same time, there has been an increase in mortgage funding by non-traditional lenders.

Similarly, the range of deposit products expanded; in 1980, those available to most consumers consisted of passbook accounts and term deposits. Only a small number of consumers, often those running businesses, had personal cheque accounts. Cheque accounts were held with one of the 10 trading banks, and each bank offered only a single type of cheque account product in 1980. In 1996, there were 1,800 different types of deposit accounts on offer. An innovation over the period 1980-1996 has been comprehensive banking service packages which include various combinations of savings, loan (including lines of credit) and transaction services; some include full interest offset with no formal loan installments, no monthly repayments and full, automatic redraw.

While it is claimed that members need more information about superannuation, it is not obvious that there is unambiguous objective information which will be conveyed to members; industry participants will wish to present training in conventions of funds management industry and propaganda to members to maintain the status quo. The most constructive action to provide more information for members would be for APRA to and release all information about individual superannuation funds on a searchable database.

In 2003, the ANZ Bank released a survey of financial literacy but the survey is unable to resist editoralising about the results and pushing the propaganda line that the current superannuation arrangements will provide "adequate" levels of retirement benefits. The survey found:

> "Of those with superannuation, 50% considered it would be adequate for their retirement.
> Given the limited extent of planning (37% had worked out how much they needed to retire),"
>
> *But was unable to resist the unwarranted assertion that*
>
> "…the reality is that this is unlikely to be the case, indicating that many may have a false sense of security regarding superannuation".

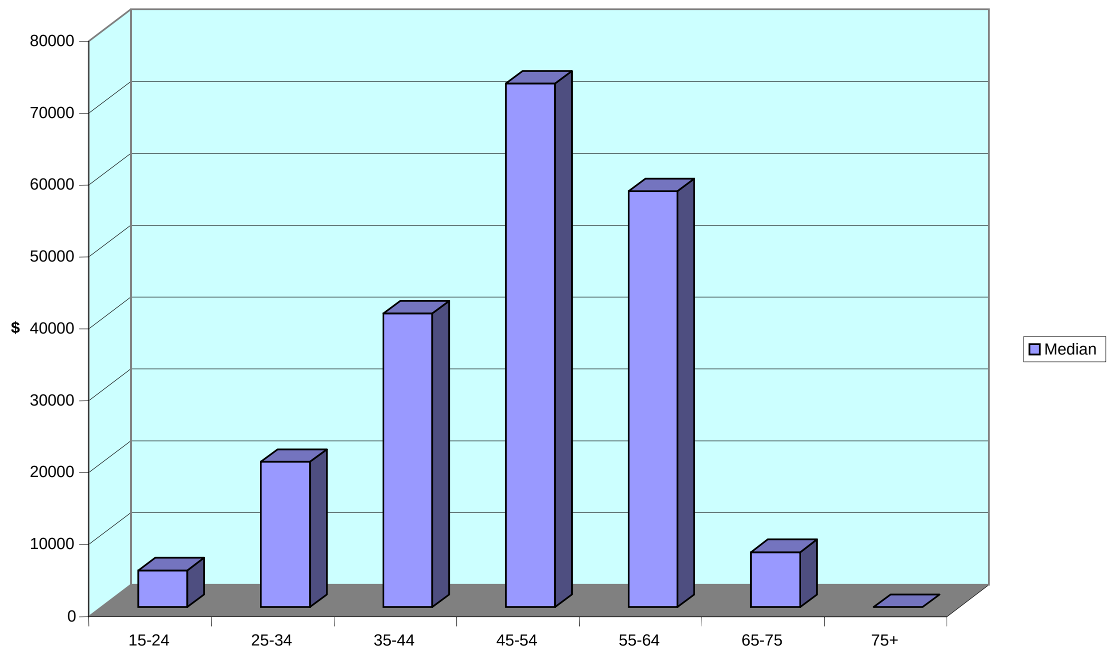
Superannuation currently provides a retirement income for only a small proportion of retirees and this position will not change significantly over the next 20 years. Currently 54 per cent of persons eligible by age for an Age Pension receive a full rate pension and another 28 per cent receive a part pension. The Treasury's Intergenerational Report estimates that, in 2040, 50 per cent of persons of pension age will receive an age pension. This is as a result of the low workforce participation rate of people over 45 years of age; currently 38 per cent of people aged 55-64 years are in receipt of Commonwealth government income support (so that over half of people receiving an age pension move seamlessly on to that pension from another benefit).

The results of a survey about attitudes to retirement income, risks ("Retirement Savings - Drivers and Desires") conducted by IFSA indicated that respondents showed a strong preference for a lump sum on retirement, were highly averse to risk, and were averse to retirement income products with little or no residual value, no possibility of withdrawal of capital and no age pension benefits Drew, Stanford and Stanhope (2003). The data from the Drivers and Desires project revealed that 85 per cent of retirees receive a pension and that the pension is the principal source of income for 75 per cent of retirees. We concluded that retirees act as rational, self-seeking economic agents in structuring their financial affairs in order to obtain the age pension and that pension policy contain substantial disincentives to save[5].

[5] We considered a specific example of a couple retiring with the mean capital sum of $234,000, in September 2002, which is the mean sum as reported in Drivers and Desires. The couple could purchase the equivalent of the age pension through a growth pension for $224, 837 leaving assets of $9,163. Alternatively, they could spend $24,337 in ways which would not affect their eligibility for an age pension, and retain $200, 500 in assets.

Figure 3 illustrates that the median level of superannuation by household; households with a head of aged 55-64 have median superannuation assets of less than $60,000 which is significantly below the maximum allowed under the age pension .

Figure 3: Household Superannuation Assets, Australia, 2000, by Age, Median



Source: Northwood et al. (2002)

The Senate Select Committee on Superannuation

This Committee, which reported on the portability proposals in September 2003, purported to support the principle of portability and the ability of individuals to consolidate their superannuation accounts (pxiii) but believes that portability out of an active account is an issue which is better dealt with through choice of funds legislation on the grounds of efficiency and consumer protection (pxiv). It should be noted that the Committee opposed the choice of funds proposals and the Senate rejected the choice of funds bill.

The opposition to transfers from active funds i.e. a fund into which SG contribution are being made on the grounds that such transfers constitute choice of funds. A submission cited by the Committee expressed the view:

> “Portability without choice could become a backdoor version of choice: the employer pays contributions into a fund and the employee systematically channels them into a different fund.”

The attitude embodied in this quotation is that employer sovereignty not consumer sovereignty should prevail at all times.

The appropriate response to the hypothetical situation above is to say that if employees do not prefer the fund that their employer has chosen for them without their permission the employer's choice should be overridden. It is our argument that it is not the role of the employer to tell employees that their preferences cannot be met.

The Committee expressed concerns that 'portability out of active superannuation accounts could lead to an increase in superannuation account numbers in Australia, rather than the desired decrease". The Committee does not provide any analysis to support this assertion; on any reasonable analysis, it is improbable in the extreme. To be true it would require portability to lead to the opening of more accounts than would be closed. In any case, even if this improbable assertion were true, why would it be a problem? The increase in accounts would be the result of choice of members.

The Senate Committee has been wound up and this Report will be its last. This is a suitable outcome as there have been substantial systematic problems with the Committee's mode of operation and its conclusions. The Committee has acted only on submissions and in doing so has implicitly assumed that all submissions are of value and all submissions are of equal value. The Committee does not investigate issues raised in the submissions much less take expert advice. The best example of this is that the Committee does not consider the Wallis Committee findings and has not sought to obtain advice from any members of the Wallis Committee. The result is that submissions are dominated by self-interest parties who are allowed to make uncontested assertions and have these assertions regarded as factual and valid[6].

The assertions are propaganda for the views of the self-interest parties and are often self contradictory. One example of this relates to timing of portability. The Corporate Super Fund Association suggested that members could time their departure from a fund where reserves have been allocated and re-enter when reserves have climbed (p55). This contrasts to the view that members do not understand superannuation and need education to be able to make an informed choice; at the same time it is held that members can engage in a complex strategy. We would argue, in any case, that members should seek to maximize their returns to superannuation so that seeking to join a fund with higher reserves is a rational strategy.

[6] One instance is in relation to group life insurance; most superannuation funds provide compulsory life cover. Funds argue (p31) portability may affect the willingness of insurers to provide group cover. However, it appears that funds provide life cover for their own benefit, to obtain commission from premiums, for trustees and other parties to obtain benefits from insurance companies. An important issue is that members may not opt out of group insurance; we have evidence that funds have no provision for members to elect that their premium be used to increase their superannuation benefits.

The appropriate response of a fund, in these circumstances, is not to deny portability but not to hold reserves. The Corporate Super Fund Association assets that the objectives of holding reserves to smooth crediting rates is to promote fairness between members and/or to promote the understanding that returns are stable over time. Promoting fairness between members in an accumulation fund requires that returns are credited to members' account when they are earned. The notion that "returns are stable over time" is counter-factual; members understand only too well given the performance of superannuation funds over the last three years that returns are highly volatile over time and that funds are unable to reduce this volatility.

CONCLUDING COMMENTS

The economic case for portability of superannuation is based on the fundamental principle of consumer sovereignty and the prediction that economic welfare and economic efficiency would be increased by the adoption of portability. Portability is necessary in relation to defined contribution funds whose members bear the investment risk. The vast majority of members belong to this type of fund. The objectives of members of defined contribution funds is to maximize their retirement benefit i.e. the terminal benefit paid by their superannuation fund. The strategy to achieve this is to minimize fees paid in superannuation and to use a passive asset selection strategy.

Portability is opposed by trustees and fund managers who fear that their economic interests will be harmed by portability. These fears are well based; portability would be predicted to reduce the number of superannuation accounts and bring about a transfer of balances from actively managed funds to passively managed funds.

Although it may be preferable, in principle, to provide more information to members of funds, we argue that there is enough information available now to allow members to make valid choices. Although current consumer protection measures in superannuation are inadequate, introduction of portability by placing pressures on trustees and funds managers is the most effective form of improving consumer protection.

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